

CHAPTER 41
DETERMINATION OF TAXABLE INCOME

[Prior to 12/17/86, Revenue Department[730]]

701—41.1(422) Verification of deductions required. Deductions from gross income, otherwise allowable, will not be allowed in cases where the department requests the taxpayer to furnish information sufficient to enable it to determine the validity and correctness of such deductions, until such information is furnished. For taxpayers using an electronic data interchange process or technology also see 701—subrule 11.4(4).

This rule is intended to implement Iowa Code section 422.25.

701—41.2(422) Federal rulings and regulations. In determining whether “taxable income,” “net operating loss deduction” or any other deductions are computed for federal tax purposes under, or have the same meaning as provided by, the Internal Revenue Code, the department will use applicable rulings and regulations that have been duly promulgated by the commissioner of internal revenue, unless the director has created rules and regulations or has exercised discretionary powers as prescribed by statute which calls for an alternative method for determining “taxable income,” “net operating loss deduction” or any other deduction, or unless the department finds that an applicable internal revenue ruling or regulation is unauthorized according to the Iowa Code.

This rule is intended to implement Iowa Code sections 422.7 and 422.9.

701—41.3(422) Federal income tax deduction and federal refund. Federal income taxes paid or accrued during the tax year are a permissible deduction for Iowa income tax purposes, adjusted by any federal refunds received or accrued during the tax year. Taxpayers who are not on an accrual basis of accounting shall deduct their federal income taxes in the year paid.

41.3(1) Federal income tax deduction. The federal income tax deduction for cash basis taxpayers equals the sum of the following:

a. The entire amount of federal income tax withheld during the taxable year from compensation of the taxpayer. Where a husband and wife file separate returns or separately on a combined Iowa return, the actual federal income tax withheld from wages earned by either spouse or both spouses must be deducted by each in accordance with wage statement(s) and may not be prorated between the spouses.

b. Tax paid at any time during the taxable year on a filing of federal estimated tax or on any amendment to such filing. Where a husband and wife file separate Iowa returns or separately on a combined Iowa return, the federal estimated tax payments made in the tax year shall be prorated between the spouses by the ratio of each spouse’s income not subject to withholding to the total income not subject to withholding of both spouses, including the federal estimated tax payment made in January of the tax year which was made for the prior tax year. If an estimated tax payment or portion of the payment is made for self-employment tax, then the spouse who has earned the self-employment income shall report the amount of estimated tax designated as self-employment tax. The federal tax deduction for the tax year does not include the self-employment tax paid through the federal estimated payments made in the tax year. However, one-half of the self-employment tax paid in the tax year is deductible in computing federal adjusted gross income pursuant to Section 164(f) of the Internal Revenue Code so this self-employment tax is also deductible in computing net income.

c. Any additional federal tax on a prior federal return paid during the taxable year. Where a husband and wife file separately or separately on a combined Iowa return, additional federal tax paid shall be prorated between the spouses by the ratio of net income reported by each spouse to total net income of both spouses in the year for which the additional federal tax was paid. If additional federal tax paid includes federal self-employment tax, then that amount of self-employment tax shall be deducted by the spouse who earned the self-employment income. Any federal tax paid for a tax year in which an Iowa individual income tax return was not required to be filed is not allowed as a deduction in the year the federal taxes were paid.

EXAMPLE 1. Individual A earned \$8,500 in income for the 2004 tax year and paid \$200 in federal tax with the filing of the federal return in 2005. Individual A was not required to file an Iowa return for 2004 because the Iowa net income was under \$9,000. Individual A cannot claim a deduction for the \$200 in federal tax paid on the 2005 Iowa return because an Iowa return was not required to be filed for the 2004 tax year.

EXAMPLE 2. Individual B moved into Iowa on January 1, 2005, and filed an initial Iowa individual income tax return for the 2005 tax year. Individual B paid \$1,000 in additional federal income tax with the filing of the 2004 federal income tax return in 2005. Individual B cannot claim a deduction for the \$1,000 in federal tax paid on the 2005 Iowa return because an Iowa return was not filed for the 2004 tax year.

d. The earned income credit computed under Section 32 of the Internal Revenue Code and the additional child tax credit computed under Section 24(d) of the Internal Revenue Code, to the extent that these credits reduce the federal income tax liability on the prior federal return filed during the taxable year. Where a husband and wife file separately or separately on a combined Iowa return, the earned income credit and the additional child tax credit shall be prorated between the spouses by the ratio of net income reported by each spouse to total net income of both spouses in the year for which these credits were claimed.

EXAMPLE: Individual A filed a 2003 federal income tax return reporting a tax liability of \$2,000. Individual A had \$500 of federal income tax withheld and \$2,500 of earned income credit. Individual A can deduct \$500 as a federal income tax deduction on the Iowa return for 2003 and \$1,500 as a federal tax deduction on the Iowa return for 2004, since the federal tax deduction is limited to the extent it reduced the federal income tax liability.

e. The motor vehicle fuel tax credit computed under Section 34 of the Internal Revenue Code for the taxable year. Where a husband and wife file separately or separately on a combined Iowa return, the motor vehicle fuel tax credit shall be prorated between the spouses by the ratio of net income reported by each spouse to total net income of both spouses in the year for which these credits were claimed.

EXAMPLE: Individual B filed a 2003 federal income tax return reporting a tax liability of \$1,500. Individual B paid \$1,000 in federal estimated tax during 2003 and claimed a \$400 motor vehicle fuel tax credit on the 2003 federal return. Individual B can deduct \$1,400 as a federal income tax deduction on the Iowa return for 2003.

41.3(2) Federal income tax refunds.

a. Any refund of federal income tax received during the taxable year must be used to reduce the amount deducted for federal income tax to the extent the refunded amount was deducted on the Iowa return in a prior year. When a husband and wife file separately or separately on a combined Iowa return, the federal income tax refund to be reported shall be prorated between the spouses by the ratio of net income reported by each spouse to total net income reported by both spouses. If an amount of self-employment tax is required to be added back to Iowa net income, then the spouse who earned the self-employment income which generated the self-employment tax shall report that amount as an addition to net income. Any federal tax refund received for a tax year in which an Iowa individual income tax return was not required to be filed is not required to be reported in the year the federal refund was received.

EXAMPLE 1: Individual A earned \$7,500 in income for the 2004 tax year and had \$1,000 in federal income tax withheld. Individual A received a refund of the entire \$1,000 federal tax withheld with the filing of the federal return in 2005. Individual A was not required to file an Iowa return for 2004 because the Iowa net income was under \$9,000. Individual A does not have to report the \$1,000 federal refund received on the 2005 Iowa return because an Iowa return was not required to be filed for the 2004 tax year.

EXAMPLE 2: Individual B moved into Iowa on July 1, 2005, and filed an initial Iowa individual income tax return for the 2005 tax year. Individual B received a \$2,000 federal income tax refund with the filing of the 2004 federal income tax return in 2005. Individual B does not have to report the \$2,000 federal refund on the 2005 Iowa return because an Iowa return was not filed for the 2004 tax year.

b. Any portion of the federal refund received due to the earned income credit computed under Section 32 of the Internal Revenue Code or the additional child tax credit computed under Section 24(d) of the Internal Revenue Code does not have to be reported on the Iowa return. However, any portion of the federal refund received due to the motor vehicle fuel tax credit computed under Section 34 of the Internal Revenue Code does have to be reported on the Iowa return.

EXAMPLE 1: Individual A filed a 2003 federal income tax return reporting a tax liability of \$2,000. Individual A had \$500 of federal income tax withheld and \$2,500 of earned income credit and received a federal income tax refund of \$1,000 after filing the return in 2004. Individual A does not have to report the \$1,000 federal refund on the Iowa return for 2004, since the refund resulted from the earned income credit.

EXAMPLE 2: Individual B filed a 2003 federal income tax return reporting a tax liability of \$500. Individual B had \$1,000 of federal income tax withheld and \$1,000 of earned income credit and received a federal income tax refund of \$1,500 after filing the return in 2004. Individual B must report a \$500 federal refund on the Iowa return for 2004, since the portion of the refund relating to the earned income credit does not have to be reported.

EXAMPLE 3: Individual C filed a 2003 federal income tax return reporting a tax liability of \$1,000. Individual C paid \$900 in federal estimated tax and claimed a \$400 federal motor vehicle fuel tax credit and received a federal refund of \$300 after filing the return in 2004. Individual C must report the \$300 federal refund on the Iowa return for 2004, since the refund resulted from the motor vehicle fuel tax credit.

41.3(3) Federal income tax deduction—part-year residents.

a. For tax years beginning on or before December 31, 1981, the federal income tax deduction attributable to Iowa by part-year residents shall be determined by multiplying the federal tax paid or accrued for the entire taxable year by a fraction, the numerator of which is the Iowa net income and the denominator of which is the federal adjusted gross income except that the taxpayer can deduct actual federal income tax withheld on that income subject to withholding which was earned while the taxpayer was an Iowa resident if the federal tax withheld on the Iowa income is separately shown on the wage statement(s) of the taxpayer.

b. For tax years beginning on or after January 1, 1982, the federal income tax deduction attributable to Iowa by part-year residents shall be the same deduction as is available for resident taxpayers.

41.3(4) Federal income tax deduction—nonresidents.

a. For tax years beginning on or before December 31, 1981, the federal income tax deduction attributable to Iowa by nonresidents shall be determined by multiplying the federal tax paid or accrued for the entire taxable year by a fraction, the numerator of which is the Iowa net income and denominator of which is the federal adjusted gross income.

If separate Iowa nonresident returns are filed by a husband and wife who filed a joint federal return, each spouse's Iowa adjusted gross income must be divided by the total federal net income of both spouses in order to compute a ratio that can be used to determine the federal tax deduction attributable to each spouse. In any event, the ratio including the combined ratio of husband and wife cannot exceed 100 percent.

Federal income taxes paid during the taxable year on prior years' federal income tax returns will not be allowable on the nonresident return for the taxable year unless Iowa returns were filed for the prior years for which the federal taxes were paid.

Any federal income tax, either paid by a nonresident or withheld from their compensation, which is later refunded to the taxpayer, shall be included as Iowa income by the nonresident for the year the refund is received, in the same portion that such federal tax was deducted by the nonresident in a prior Iowa income tax return.

b. For tax years beginning on or after January 1, 1982, the federal income tax deduction attributable to Iowa by nonresidents of Iowa shall be the same deduction as is available for resident taxpayers.

41.3(5) *Federal rebate received in 2001.* For tax years beginning in the 2001 calendar year, the federal tax rebate or advanced refund of federal income tax provided to certain individuals in 2001 pursuant to the federal Economic Growth and Tax Relief Reconciliation Act of 2001 is not to be included as part of an individual's federal income tax refund for the individual's federal tax deduction for Iowa individual income tax purposes. The federal rebate is also referred to as the tax reduction credit.

EXAMPLE. John and Betty Smith received a federal refund of \$1,200 in March 2001 from federal income tax that had been deducted on their 2000 Iowa individual income tax return. The Smiths also received a refund of federal income tax of \$500 in June 2001 from an amended 1999 federal return. The federal income tax refunded had been deducted on the Smiths' 1999 Iowa income tax return. Finally, the Smiths received a \$600 federal rebate in August 2001. When the Smiths file their 2001 Iowa return, they must report an aggregate federal income tax refund of \$1,700. This is \$1,200 from the refund from their 2000 federal return and \$500 from the refund from their amended 1999 federal return. However, the Smiths are not to include as part of the federal income tax refund shown on their 2001 Iowa return the \$600 federal rebate they received in August 2001.

41.3(6) *Federal rate reduction credit and the federal income tax deduction for the 2002 tax year.* For tax years beginning in the 2002 calendar year, the tax reduction credit or the advanced refund of federal income tax provided to certain individuals pursuant to the federal Economic Growth and Tax Relief Reconciliation Act of 2001 is not to be included as part of an individual's federal income tax refund for Iowa individual income tax purposes. The tax reduction credit was also referred to as the federal rebate when it was refunded to some taxpayers during the 2001 calendar year. This subrule does not apply to those taxpayers who received the federal rebate in the 2001 calendar year.

EXAMPLE. When Joe and Donna Brown completed their 2001 federal income tax return, they received the benefit of a rate reduction credit of \$600 which resulted in the Browns' receiving a federal income tax refund of \$400 in May 2002. Because the entire federal income tax refund was attributable to the rate reduction credit of \$600, the Browns do not need to report the \$400 refund of federal income tax when they complete their Iowa income tax return for 2002.

This rule is intended to implement Iowa Code section 422.9 as amended by 2005 Iowa Acts, Senate File 413.

701—41.4(422) *Optional standard deduction.* An optional standard deduction is provided on the Iowa individual income tax return for both residents and nonresidents. In the case of married taxpayers filing separate returns or separately on the combined return, if one spouse takes the optional standard deduction, the other spouse must also take the optional standard deduction. The standard deduction claimed by the taxpayer may not exceed the taxpayer's income before the standard deduction.

A taxpayer has the option of itemizing deductions or of using the optional standard deduction on the Iowa return, regardless of the deduction method used on the federal return.

For tax years beginning on or after January 1, 1990, the optional standard deduction amounts are indexed or increased for inflation by the cumulative standard deduction factor. The cumulative standard deduction factor is described in rule 701—38.12(422).

41.4(1) *Direct charitable contribution for individuals claiming the optional standard deduction.* For tax years beginning on or after January 1, 1984, a direct charitable deduction is provided for resident and nonresident taxpayers who claim the optional standard deduction on their Iowa returns. The deduction is limited to 25 percent of the first \$300 donated to qualified organizations as defined in Section 170(b)(1)(A) of the Internal Revenue Code. Married taxpayers who have filed a joint federal return and elect to file separate Iowa returns or separately on the combined Iowa return must allocate the allowable charitable deduction to each spouse in the proportion that each spouse's respective net income bears to the total net income of both spouses. The example shown below illustrates how the direct charitable deduction is allocated between spouses filing separate Iowa returns or separately on the Iowa combined return form.

A married couple filed a joint federal return but elected to file a combined return for Iowa income tax purposes. In the tax year, the couple made \$400 in contributions to qualified organizations and elected to claim the optional standard deduction on their Iowa return. The husband's net income for the year was \$30,000 and the wife's net income was \$10,000. The couple's direct charitable deduction is limited to 25 percent of the first \$300 in contributions made during the year which gave them a direct charitable deduction of \$75. This deduction was allocated between the husband and wife on the basis of the following formula:

$$\text{Allowable Direct Charitable Contribution} \times \frac{\text{Husband's Net Income}}{\text{Total Net Income}} = \text{Husband's Deduction}$$

$$\text{Allowable Direct Charitable Contribution} \times \frac{\text{Wife's Net Income}}{\text{Total Net Income}} = \text{Wife's Deduction}$$

$$\$75 \times \frac{\$30,000}{\$40,000} = \$56 \text{ Husband's Deduction}$$

$$\$75 \times \frac{\$10,000}{\$40,000} = \$19 \text{ Wife's Deduction}$$

Therefore, the husband's direct charitable deduction is \$56 and the wife's deduction is \$19.

For federal income tax purposes, the direct charitable contribution deduction for taxable years beginning in 1985 is limited to 50 percent of the total contributions given. For taxable years beginning in 1986, the direct charitable contribution deduction allowable on the federal return is 100 percent of the contributions made in the tax year. However, for Iowa income tax purposes, the maximum direct charitable contribution that is allowable for tax years beginning in 1985 and 1986 is 25 percent of up to the first \$300 contributed. The direct charitable deduction is not allowed on either Iowa or federal income tax returns for tax years beginning after 1986.

41.4(2) Reserved.

This rule is intended to implement Iowa Code sections 422.4 and 422.9.

701—41.5(422) Itemized deductions. Deductions may be itemized on the Iowa return to the same extent that they are allowable on the federal return with the following exceptions:

41.5(1) To the extent that Iowa income taxes were included in itemized deductions allowable for federal income tax purposes, they must be subtracted from the itemized deductions to be deducted on the Iowa return.

41.5(2) For the tax years beginning on or after January 1, 2004, and before January 1, 2006, the itemized deduction for state sales and use taxes is allowed on the Iowa return only if the taxpayer elected to deduct state sales and use taxes as an itemized deduction in lieu of the deduction for state income taxes on the federal return under Section 164 of the Internal Revenue Code.

If the taxpayer elected to deduct state income taxes as an itemized deduction on the federal return, taxpayer cannot claim an itemized deduction for state sales and use taxes on the Iowa return. In addition, if taxpayer claimed the standard deduction in accordance with Section 63 of the Internal Revenue Code on the federal return, taxpayer cannot claim an itemized deduction for state sales and use taxes on the Iowa return.

If the taxpayer is allowed to deduct state sales and use taxes as an itemized deduction on the Iowa return, taxpayer cannot claim an itemized deduction on the Iowa return for either the school district surtax imposed under Iowa Code section 257.21 or the emergency medical services income surtax imposed under Iowa Code chapter 422D.

41.5(3) Adoption expense deduction.

a. Reduce federal itemized deductions by any amounts of adoption expenses allowed under Section 222 of the Internal Revenue Code. This deduction is applicable for tax years beginning on or after January 1, 1981, but before January 1, 1987.

b. Unreimbursed amounts paid by the taxpayer in the adoption of a child if placed by a licensed agency under Iowa Code chapter 238, by an agency that meets the provision of the interstate compact in Iowa Code section 232.158 or by a person making an independent placement under Iowa Code chapter 600, which exceed 3 percent of the taxpayer's net income, or the combined net income of a husband and wife in the case of married taxpayers filing a joint return, will be allowed as a deduction in the year paid. Qualifying expenses include all medical, hospital, legal fees, welfare agency fees, and all other costs relating to the adoption of a child. Those expenses claimed for adoption purposes may not be claimed elsewhere on the individual income tax return. Adoption expenses paid or incurred prior to January 1, 1977, in connection with the adoption of a child, which exceed 3 percent of the taxpayer's net income, will be allowed only if the child was placed by a licensed agency under Iowa Code chapter 238 or by an agency that meets the provisions of the interstate compact in Iowa Code section 232.158.

41.5(4) Deduction for expenses for the care of certain disabled relatives.

a. For tax years beginning on or after January 1, 1983, a deduction from net income may be taken for expenses incurred by a taxpayer for care of a disabled person who is unable to live independently. Such care must be provided in the home in which the taxpayer resides throughout the year. A person is considered to be incapable of living independently if as a result of a physical or mental defect the person is incapable of caring for the person's hygienical or nutritional needs or requires the full-time attention of another person for personal safety or the safety of others. The fact that an individual, by reason of a physical or mental defect, is unable to engage in any substantial gainful activity, or is unable to perform the normal household functions of a homemaker or to care for minor children, does not of itself establish that the individual is physically or mentally incapable of self-care. An individual who is physically handicapped or is mentally defective, and for such reason requires the constant attention of another person, is considered to be physically or mentally incapable of self-care.

To qualify for the deduction, in addition to being disabled, the person must be the grandchild, child, parent or grandparent of the taxpayer or the taxpayer's spouse, and

- (1) Be receiving medical assistance benefits under Iowa Code chapter 249A; or
- (2) Be eligible to receive such benefits under the income and resource levels established in Iowa Code chapter 239B; or
- (3) Would be eligible to receive such benefits if living in a health-care facility licensed under Iowa Code chapter 135C.

Expenses incurred for a taxpayer's disabled spouse do not qualify for the deduction.

b. The deductible amount is limited to \$5,000 for each disabled person cared for in the taxpayer's home and the expenses must not be otherwise deductible as a deduction from net income under Iowa Code section 422.9.

c. Qualifying expenses include a proportionate share of food expenses as well as amounts spent directly on the disabled person for such items as clothing, medical care, dental care and transportation.

Medical expenses incurred for a disabled relative, which are eliminated from federal itemized deductions because of the federal adjusted gross income percentage limitation, may be included in the deduction for expenses incurred for the care of the disabled relative providing the other requirements are met. Following are examples to illustrate the portion of medical expenses incurred which would be deductible.

EXAMPLE 1. Mr. and Mrs. Smith care for Mrs. Smith's mother in their home. Mrs. Smith's mother is physically unable to live independently and qualifies for medical assistance benefits under Iowa Code chapter 249A. Mr. and Mrs. Smith paid medical expenses of \$1,500 for themselves and \$500 for Mrs. Smith's mother. The medical expenses for Mrs. Smith's mother are includable as federal itemized deductions. Mr. and Mrs. Smith's federal adjusted gross income is \$20,000. For 1983, the federal deduction for medical expenses would be \$1,000 (\$2,000 minus 5 percent of \$20,000 or \$1,000). Since the deductible amount for federal tax purposes is \$1,000 or 50 percent of the total medical expenses of Mr. and Mrs. Smith and Mrs. Smith's mother, there remains 50 percent of the \$500 expense for Mrs. Smith's mother (or \$250) which can be included in the Iowa deduction for a disabled relative.

EXAMPLE 2. Mr. and Mrs. Smith's medical expenses were \$400 and Mrs. Smith's mother's expenses were \$200. None of the \$600 in expenses would be deductible as a federal itemized deduction but the mother's \$200 in expenses would be includable in the Iowa deduction for expenses incurred for a disabled relative.

d. Expenses not directly related to care of a disabled relative are not deductible. This category includes rent, mortgage interest, utilities, house insurance and taxes. Such expenses would be incurred without the disabled relative in the home and unless an expense can be directly attributed to the disabled relative, it may not be deducted.

e. In the event that the person being cared for is receiving assistance benefits under Iowa Code chapter 239B, the expenses qualifying for deduction shall be the net difference between the expenses actually incurred in caring for the person which are not otherwise deductible as a deduction to net income and the assistance benefits under Iowa Code chapter 239B. Iowa Code chapter 239B covers family investment program payments.

f. In order to claim a deduction for expenses for care of a disabled relative, a schedule of qualifying expenses must be provided with the tax return as well as a statement from a qualified physician certifying that the disabled individual is unable to live independently. Such certification must be filed with the tax return in the initial year for the deduction and every third year thereafter.

41.5(5) Deduction for payments of tuition and textbooks for dependents in grades kindergarten through 12 in Iowa. For tax years beginning on or after January 1, 1987, but prior to January 1, 1996, individuals who itemize deductions for Iowa income tax purposes may claim a deduction of up to \$1,000 per dependent for amounts paid for tuition and textbooks for those dependents attending grades kindergarten through 12 in Iowa. Taxpayers who itemize deductions on Iowa individual income tax returns for tax years beginning on or after January 1, 1996, and have tuition and textbook expenses may claim the tax credit described in 701—subrule 42.2(8) if they meet the qualifications for the credit. In order to qualify a taxpayer for the deduction for tuition and textbooks, the elementary school or secondary school the dependent is attending must meet the standards for accreditation of public and nonpublic schools in Iowa provided in Iowa Code section 256.11.

In addition, the elementary school or secondary school the dependent is attending must not be operated for profit and must adhere to the provisions of the United States Civil Rights Act of 1964, and the provisions of Iowa Code chapter 216 which is known as the Iowa civil rights Act of 1965.

Amounts paid for tuition and textbooks for attendance of a dependent in a nursery school or a pre-kindergarten school or a school for postgraduates of a secondary school do not qualify for the deduction for tuition and textbooks.

The deduction for tuition and textbooks is not allowed on returns for taxpayers that have federal adjusted gross incomes of \$45,000 or more. In the case of married taxpayers, the deduction is not allowed if the combined federal adjusted gross income of the taxpayer and spouse is \$45,000 or more. For tax years beginning on or after January 1, 1991, taxpayers' net incomes instead of their federal adjusted gross incomes are used to determine whether or not the taxpayers are eligible for the tuition and textbook deduction or the tuition and textbook credit. Therefore, a taxpayer filing a 1991 state income tax return would not be eligible for the tuition and textbook deduction if the taxpayer's Iowa net income was \$45,000 or more even if the taxpayer's federal adjusted gross income was less than \$45,000.

The following definitions and criteria apply to the itemized deduction for amounts paid for tuition and textbooks:

a. "Tuition" means any charges for the expense of personnel, buildings, equipment and materials other than textbooks, and other expenses of elementary or secondary schools which relate to the teaching only of those subjects legally and commonly taught in public schools in Iowa. "Tuition" includes charges by a qualified school for summer school classes or for private instruction of a child who is physically unable to attend classes at the site of the school.

"Tuition" does not include charges or fees which relate to the teaching of religious tenets, doctrines, or worship in cases where the purpose of the teaching is to inculcate the religious tenets, doctrines, or worship. It does not include amounts paid to an individual instructor for private instruction of a dependent. "Tuition" also does not include amounts paid to a school which pertain to "extracurricular activities" which are described in paragraph "c" of this subrule. Amounts paid to a school for meals, lodging, or clothing of a dependent do not qualify for the deduction for "tuition."

b. "Textbooks" means books and other instructional materials used in elementary and secondary schools in teaching only those subjects legally and commonly taught in public elementary and secondary schools in Iowa. Fees or charges by the school for required supplies or materials for classes in art, home economics or shop qualify for the deduction as "textbooks."

"Textbooks" does not include amounts paid for instructional materials used in the teaching of religious tenets, doctrines, or worship in cases where the purpose of the teaching is to inculcate the religious tenets, doctrines, or worship. The deduction for "textbooks" also does not include amounts incurred for books, supplies, or materials used for "extracurricular activities." "Extracurricular activities" are described in paragraph "c" of this subrule.

c. "Extracurricular activities" includes sporting events such as football, wrestling, basketball, volleyball, and track. It also includes plays or dramatic events, speech activities such as debates, concerts, dances, band contests, choral contests and events, contests and activities of a similar nature. Driver's education is considered to be an "extracurricular activity" for purposes of the deduction for tuition and textbooks. Therefore, even if driver's education is taken for credit toward a student's graduation requirements, amounts paid for tuition or for textbooks for driver's education may not be taken as part of the deduction for tuition and textbooks.

d. Divorced or separated taxpayers who pay amounts for tuition and textbooks for their children attending grades kindergarten through 12 in Iowa can claim the deduction for tuition and textbooks only if the amounts paid are for children the taxpayers can claim as dependents on their Iowa returns for the tax year.

e. Records to be retained to support the deduction for tuition and textbooks. Taxpayers claiming a deduction for amounts paid for tuition and textbooks must complete statements and information documenting the deduction. The statement must include the following information: name of each dependent for which the deduction is claimed; name and address of each school the dependent attended where amounts were paid for tuition and textbooks; amounts paid for tuition which qualify for the deduction; amounts paid for textbooks which qualify for the deduction; total amount paid for tuition and textbooks which qualifies for the deduction for each dependent (not to exceed \$1,000); and the total amount paid by the taxpayer for tuition and textbooks for all dependents which qualifies for the deduction. This statement should be retained so it may be provided to the department of revenue in case of audit. Other records supporting the deduction which should also be retained include canceled checks, receipts, statements of charges for tuition and textbooks from primary and secondary schools, and any other documents which support the deduction.

f. Proration of amounts paid for tuition which pertain to classes for subjects legally and commonly taught in public schools in Iowa. To the extent that the total amount paid to a school for tuition for a dependent attending grades kindergarten through 12 at a primary or secondary school pertains to classes for subjects legally and commonly taught in public schools in Iowa, the amount paid is deductible. In instances where there are separate tuition charges for extracurricular activities or for classes for religious instruction, those tuition charges do not qualify for the deduction for tuition and textbooks. However, in situations where the total tuition charges of a school for a dependent cover extracurricular activities and classes for religious instruction as well as classes for subjects legally and commonly taught in public schools in Iowa, a proration of the tuition must be made to determine the portion of the tuition charges that are deductible. The tuition deduction for a dependent may be calculated on the basis of the time spent by the dependent in classes for subjects legally and commonly taught in Iowa's public schools to the total time spent by the dependent in school. For example, a taxpayer paid \$500 to a private school for tuition for a dependent for a semester. During the semester, the dependent had eight class periods each school day. The dependent spent one period in a class for religious instruction. The dependent had another period in the school day spent in practice for an extracurricular activity. The dependent spent the rest of the school day in classes for subjects legally and commonly taught in Iowa's public schools. Seventy-five percent of the dependent's time at the school was spent in classes for subjects legally and commonly taught in Iowa's public schools. Therefore, 75 percent of the tuition paid for the semester or \$375 qualifies for the deduction for tuition and textbooks.

g. Allocation of amounts paid for tuition and textbooks between married taxpayers filing separately. In the case of married taxpayers who have paid amounts for tuition and textbooks for a dependent attending an elementary school or secondary school in Iowa, the deduction for tuition and textbooks must be allocated between the spouses if the taxpayers elect to file separate Iowa returns or separately on the combined return form. The deduction for tuition and textbooks must be allocated between the spouses in the ratio of each spouse's net income to the combined net income of both spouses unless one spouse can prove that all the amounts paid for tuition and textbooks were paid by that spouse.

41.5(6) Rescinded IAB 11/24/04, effective 12/29/04.

41.5(7) Deduction of multipurpose vehicle registration fee. For tax years beginning on or after January 1, 1992, and before January 1, 2005, individuals who itemize deductions for Iowa income tax purposes may claim a deduction for 60 percent of the amount of the registration fee paid for a multipurpose vehicle under Iowa Code section 321.124, subsection 3, paragraph “h.” “Multipurpose vehicle” means a motor vehicle designed to carry not more than ten people and constructed either on a truck chassis or with special features for occasional off-road operation. The registration certificate for a multipurpose vehicle has the letters “MV” printed next to the word “style” on the certificate.

This subrule applies only to model year 1992 and older model year multipurpose vehicles. The registration fees for multipurpose vehicles for the 1993 model year and for model years after 1993 are the same as for other motor vehicles where the fees for newer model year vehicles are based on the value and weight of the vehicle. In order to qualify for this deduction, no part of the multipurpose vehicle registration fee may have been deducted as an itemized deduction under Section 164 of the Internal Revenue Code or as an ordinary and necessary business expense.

See also subrule 41.5(9), which provides for the deduction for registration fees for older motor vehicles. Subrule 41.5(7) also applies to multipurpose vehicles to the extent those vehicles are for the 1993 model year or for model years after 1993.

For tax years beginning on or after January 1, 2005, the itemized deduction for Iowa income tax for multipurpose vehicle registration fees is the same as allowed under Section 164 of the Internal Revenue Code for federal tax purposes.

41.5(8) Medical expense deduction limitation. For tax years beginning on or after January 1, 1996, to the extent that a taxpayer has a medical care expense deduction on the federal return under Section 213 of the Internal Revenue Code, the taxpayer must compute the medical care expense deduction on the Iowa return by excluding those health insurance premiums deducted in computing net income in accordance with Iowa Code subsection 422.7(29) and rule 701—40.48(422).

41.5(9) Deduction of older motor vehicle registration fee. For tax years beginning on or after January 1, 2002, and before January 1, 2005, individuals who itemize deductions for Iowa income tax purposes may claim a deduction for 60 percent of the annual registration fee paid for certain older motor vehicles. This deduction applies to a 1994 model year vehicle or a newer model year vehicle that is nine model years old or older. This deduction also applies to a 1993 or older motor vehicle which has been transferred to a new owner or to a 1993 or older model vehicle that was brought into Iowa on or after January 1, 2002. However, the deduction otherwise allowed pursuant to this subrule is not allowed to the extent that the vehicle was used in the taxpayer’s trade or business so that the deduction for the registration of the vehicle has already been allowed in the computation of Iowa net income.

For tax years beginning on or after January 1, 2005, the itemized deduction for Iowa income tax for older motor vehicle registration fees is the same as allowed under Section 164 of the Internal Revenue Code for federal tax purposes.

41.5(10) Additional first-year depreciation allowance. For tax periods ending on or after September 10, 2001, any federal itemized deductions that are determined based on a percentage of a taxpayer's federal adjusted gross income may have to be adjusted for Iowa tax purposes. These itemized deductions for Iowa individual tax purposes are based on federal adjusted gross income as adjusted by the disallowance of the additional first-year depreciation allowance authorized in Section 168(k) of the Internal Revenue Code as described in rule 701—40.60(422).

EXAMPLE: Mr. and Mrs. Jones reported \$50,000 in federal adjusted gross income on their 2002 federal income tax return. Mr. and Mrs. Jones paid medical expenses of \$5,000 for 2002, but could only claim an itemized deduction for medical expenses for federal tax purposes equal to \$1,250, or to the extent the medical expenses exceeded 7.5 percent of their federal adjusted gross income (\$50,000 times 7.5% = \$3,750. \$5,000 – \$3,750 = \$1,250). Mr. and Mrs. Jones reported a \$5,000 increase in Iowa adjusted gross income due to the disallowance of additional first-year depreciation on their Iowa return for 2002. Mr. and Mrs. Jones can claim an itemized deduction on the 2002 Iowa return for medical expenses of \$875, or to the extent the medical expenses exceeded 7.5 percent of their adjusted gross income for Iowa purposes of \$55,000 (\$55,000 times 7.5% = \$4,125. \$5,000 – \$4,125 = \$875).

41.5(11) Charitable contributions made in January 2005 for relief of victims of the Indian Ocean tsunami. For cash contributions made after December 31, 2004, and before February 1, 2005, to charitable organizations for the purpose of helping victims of the Indian Ocean tsunami, the taxpayer may claim this contribution as an itemized deduction on the 2004 Iowa income tax return if the taxpayer elected to claim this contribution as an itemized deduction on the 2004 federal tax return. If the taxpayer elected to claim the cash contribution made in January 2005 as an itemized deduction on the 2005 federal tax return, then it must be claimed as an itemized deduction on the 2005 Iowa return.

This rule is intended to implement Iowa Code section 422.9 as amended by 2005 Iowa Acts, House File 186, and 2005 Iowa Acts, Senate File 413.

701—41.6(422) Itemized deductions—separate returns by spouses. Where both spouses itemize deductions, the deductions must be divided between them in the ratio that each spouse's separate Iowa net income bears to the total Iowa net income of both spouses unless each spouse can show that the spouse paid for or is entitled to accrue the deductions. It will be presumed that the deductions are paid by both spouses and must be prorated if the deductions were paid from a joint checking account of both spouses. In any event, all itemized deductions must either be prorated between spouses or must be specifically deducted by the spouse that paid for the deductions. No combinations of the two methods will be permitted.

This rule is intended to implement Iowa Code section 422.9.

701—41.7(422) Itemized deductions—part-year residents.

41.7(1) For tax years beginning on or before December 31, 1981, itemized deductions attributable to Iowa by part-year residents shall be determined by multiplying the total itemized deductions, excluding Iowa income tax expensed, by a fraction, the numerator of which is the Iowa net income and the denominator of which is the federal adjusted gross income unless the taxpayer can show the actual amount of itemized deductions paid or accrued during the period of residency in Iowa.

41.7(2) For tax years beginning on or after January 1, 1982, itemized deductions attributable to Iowa by part-year residents shall be the itemized deductions allowable for resident taxpayers.

This rule is intended to implement Iowa Code sections 422.7, 422.8 and 422.9.

701—41.8(422) Itemized deductions—nonresidents.

41.8(1) For tax years beginning on or before December 31, 1981, itemized deductions attributable to Iowa by nonresidents shall be determined by multiplying the total itemized deductions, excluding Iowa income tax expensed, by a fraction, the numerator of which is the Iowa net income and the denominator of which is the federal adjusted gross income.

If separate Iowa nonresident returns are filed by husband and wife who filed a joint federal return, each spouse's Iowa adjusted gross income must be divided by the total federal net income of both spouses in order to compute a ratio that can be used to determine the itemized deductions attributable to each spouse. In any event, the ratio including the combined ratio of husband and wife cannot exceed 100 percent.

41.8(2) For tax years beginning on or after January 1, 1982, itemized deductions attributable to Iowa by nonresidents shall be the itemized deductions available for resident taxpayers.

This rule is intended to implement Iowa Code sections 422.5, 422.7 and 422.9.

701—41.9(422) Annualizing income. Where a taxpayer is required to annualize income for federal income tax purposes the taxpayer must also annualize on the Iowa return.

This rule is intended to implement Iowa Code section 422.7.

701—41.10(422) Income tax averaging. There is no provision in the Iowa Code which allows income tax averaging.

This rule is intended to implement Iowa Code sections 422.7 and 422.5.

701—41.11(422) Reduction in state itemized deductions for certain high-income taxpayers. For tax years beginning after December 31, 1990, the itemized deductions for certain high-income taxpayers are reduced for federal income tax purposes by the lesser of 3 percent of the excess of adjusted gross income (AGI) over the applicable amount, or 80 percent of the amount of itemized deductions otherwise allowable for the taxable year. For 1991, the applicable amount is \$100,000 (\$50,000 in the case of a married person filing a separate federal return). The applicable amount is to be increased each tax year to reflect inflation in the taxable years after 1991. For example, for 1995 the applicable amount is \$114,700 (\$57,350 in the case of a married person filing a separate return). This reduction in itemized deductions for certain high-income taxpayers applies for Iowa individual income tax purposes for the same tax years that the provision applies for federal income tax purposes. The following subrules clarify how the reduction in itemized deductions is to be determined on the Iowa individual income tax return:

41.11(1) Itemized deduction worksheet (Form 41-104). High-income taxpayers who are itemizing deductions on the Iowa income tax return and whose itemized deductions for federal income tax purposes were subject to reduction because their federal adjusted gross incomes exceeded certain amounts (the amounts for 1996 were \$117,950 for all taxpayers except married taxpayers who filed separate federal returns and \$58,975 for married individuals who filed separate federal returns) must complete Itemized Deduction Worksheet (Form 41-104) to determine the amount of federal itemized deductions that can be claimed on the Iowa income tax return. This worksheet must also be used to compute the itemized deductions allowable on the Iowa return for taxpayers who claimed the standard deduction on their federal individual income tax return, but are itemizing deductions for Iowa income tax purposes and whose deductions would have been subject to reduction, if they had itemized deductions on their federal income tax return. These taxpayers must complete the worksheet (Form 41-104) as if they had itemized deductions on their federal returns. Generally, the itemized deductions allowed on the federal income tax return for high-income taxpayers are also allowed for Iowa individual income tax purposes, except that the Iowa income tax that was allowable as a deduction on the federal Schedule A is not allowed as an Iowa itemized deduction. In addition, the deduction for medical expenses claimed as an itemized deduction on the federal income tax return should be reduced by the amount of health insurance premiums claimed as a deduction on line 18 of the IA 1040. The line references on Form 41-104 are to the federal 1040 and to the federal Schedule A for 1996 and to the IA 1040 for the 1996 tax year. Similar line references will apply on Form 41-104 and to IA 1040 for any later tax year when the taxpayer's federal itemized deductions were subject to reduction because the taxpayer's federal adjusted gross income exceeded the threshold amount for that year and the taxpayer itemized deductions on the Iowa income tax return. Note that if a taxpayer's itemized deductions are less than the Iowa standard deduction amount, the taxpayer may elect to claim the Iowa standard deduction.

Form 41-104 follows:

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|--|------------|
| 1. Enter the allowable federal itemized deductions as shown on line 34 of the 1040. | 1. _____ |
| 2. Add the amounts on federal Schedule A, lines *4, 13, 19 plus any gambling losses including on line 27 and enter the total here. | 2. _____ |
| 3. Subtract line 2 amount from line 1 amount. | 3. _____ |
| 4. Add the amounts on federal Schedule A, lines *4, 9, 14, 18, 19, 26, and 27 and enter the total here. | 4. _____ |
| 5. Subtract line 2 amount from line 4 amount. | 5. _____ |
| 6. Divide line 3 by line 5 and enter percentage here. | 6. _____ % |
| 7. Enter the amount of Iowa income tax that is included in line 5 of the federal Schedule A. | 7. _____ |
| 8. Multiply line 7 by the percentage on line 6. | 8. _____ |
| 9. Subtract line 8 from line 1. Enter this amount here and on line 39 of the IA 1040. | 9. _____ |

*The deduction for medical expenses from line 4 of federal Schedule A must be reduced by the amount of any health insurance premiums that were deducted on line 18 of Form IA 1040 in computing the taxpayer's net income for the tax year.

41.11(2) Possible problem with itemized deduction worksheets for 1992, 1993, and 1994 returns.

The department has determined that some high-income taxpayers who used the itemized deduction worksheets (Form 41-104) that were provided for 1992, 1993, and 1994 Iowa returns may have claimed fewer itemized deductions than the taxpayers were entitled to claim. The high-income taxpayers who may have been affected were individuals whose itemized deductions were subject to reduction for federal income tax purposes because their federal adjusted gross incomes for the tax years exceeded certain threshold amounts. The threshold amounts for all taxpayers except married taxpayers filing separate federal returns were \$105,250 for 1992, \$108,450 for 1993, and \$111,800 for 1994. In the case of married taxpayers filing separate federal returns the threshold amounts were \$52,625 for 1992, \$54,225 for 1993 and \$55,900 for 1994. Therefore, if a high-income taxpayer completed Form 41-104 that was available for the 1992, 1993, or 1994 Iowa returns and claimed a total of itemized deductions that is less than the total itemized deductions computed using Form 41-104 that is included in this rule, or Form 41-104 that is available for the 1995 Iowa return, the taxpayer may file an amended Iowa return for the tax year to claim the higher itemized deductions amount. Amended returns filed for the increased itemized deduction amounts for 1992, 1993, or 1994 must be filed within the statute of limitations for refund specified in Iowa Code section 422.73. If the 1992 return was filed by the original due date of April 30, 1993, an amended return for that tax year must be filed on or before April 30, 1996, in order to be a valid claim for refund.

This rule is intended to implement Iowa Code sections 422.3 and 422.9.

701—41.12(422) Reduced state deduction for home mortgage interest for taxpayers with mortgage interest credit. For tax years beginning before January 1, 1996, taxpayers who qualified for the mortgage interest credit on their federal return which reduced their deduction for home mortgage interest are subject to the same reduced deduction for mortgage interest for Iowa income tax purposes. The mortgage interest credit is provided in Section 25 of the Internal Revenue Code. For example, a taxpayer paid \$6,000 in home mortgage interest in the tax year and qualified for a mortgage interest credit of \$900. Thus, the taxpayer had a federal mortgage interest deduction in the tax year of \$5,100. The Iowa mortgage interest deduction for the tax year is also \$5,100 instead of \$6,000. For tax years beginning on or after January 1, 1996, any taxpayer who had the mortgage interest credit on the federal return can claim a deduction on the Schedule A of the IA 1040 for all the mortgage interest paid in the tax year, including the mortgage interest that was not deducted on the federal return due to the mortgage interest credit.

This rule is intended to implement Iowa Code sections 422.3 and 422.9 as amended by 1997 Iowa Acts, Senate File 129.

701—41.13(422) Iowa income taxes and Iowa tax refund. As provided in subrule 41.5(1), Iowa individual income taxes paid or accrued are allowable itemized deductions for federal income tax purposes, but are not allowable itemized deductions for Iowa income tax purposes. To the extent Iowa income taxes were deducted as itemized deductions for federal tax purposes, they shall be disallowed as an itemized deduction for Iowa income tax purposes.

Refunds of Iowa income taxes to the extent that the refunds were included in the determination of federal adjusted gross income shall be allowed as a reduction to Iowa adjusted gross income, only to the extent that an itemized deduction for Iowa income taxes was disallowed on a prior Iowa return. Iowa income tax refunds resulting from Iowa refundable income tax credits are not allowed as a reduction for Iowa income tax purposes.

EXAMPLE: Individual A made Iowa estimated payments of \$2,000 during the 2003 tax year. The \$2,000 of estimated payments was claimed as an itemized deduction for federal tax purposes, but was not allowed as an itemized deduction for Iowa tax purposes. The 2003 Iowa return reported a tax liability of \$1,600. Individual A had \$2,000 of Iowa estimated payments and a \$500 ethanol blended gasoline tax credit, and received a \$900 Iowa tax refund in 2004. Of the \$900 refund reported as income on the federal return, Individual A will be allowed a \$400 (\$2,000 - \$1,600) reduction on the Iowa return for 2004.

This rule is intended to implement Iowa Code section 422.9.

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